



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended	04/10/03	Bill No:	AB 1276
Tax:	Cigarette and Tobacco Products	Author:	J. Horton
Board Position:		Related Bills:	AB 71 (J. Horton)

BILL SUMMARY

Among other things, this bill would prohibit any cigarette tax stamp or meter impression to be affixed to a package of cigarettes, or tax be paid on a tobacco product defined as a cigarette, unless the tobacco manufacturer and brand family is included on the Master Settlement Agreement compliance list posted by the Attorney General, as specified.

Summary of Amendments

The amendments to this bill since the previous analysis authorize the Attorney General to adopt rules and regulations to, among other things, establish procedures for the seizure and destruction of cigarettes forfeited to the state, including, but not limited to, the state facilities that may be used for the destruction of contraband cigarettes.

ANALYSIS

Current Law

Under existing law, the State Board of Equalization (Board) administers the Cigarette and Tobacco Products Tax Law. An excise tax of \$0.87 per package of 20 cigarettes is imposed on the distribution of cigarettes in this state. Distributors pay the excise tax by purchasing cigarette stamps, which they affix to each package of cigarettes to indicate that the tax has been paid to the state. Distributors are also required to file monthly reports with the Board indicating their distribution of cigarettes and purchase of stamps during the preceding month.

Proposed Law

This bill would add Section 30165.1 to the Revenue and Taxation Code to prohibit persons from affixing, or cause to be affixed, any tax stamp or meter impression to a package of cigarettes, or pay the tax levied pursuant to Sections 30123 and 30131.2 on a tobacco product defined as a cigarette, unless the brand family of cigarettes or tobacco product, and the tobacco product manufacturer that makes or sells the cigarettes or tobacco product, are included on a compliance list posted by the Attorney General.

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This bill would also prohibit a person from:

- Selling, offering, or possessing for sale in this state, or importing for personal consumption in this state, cigarettes of a tobacco product manufacturer or brand family not included in the Attorney General's directory, and
- Selling, distributing, acquiring, holding, owning, possessing, transporting, importing, or causing to be imported cigarettes that the person knows or should know are intended to be distributed in violation of this bill's stamping prohibitions or are not included in the Attorney General's directory.

DIRECTORY OF CIGARETTES APPROVED FOR STAMPING AND SALE

This bill would require the Attorney General to develop and publish on its Internet web site a directory listing the following:

1. All tobacco manufacturers that have provided current, timely, and accurate certifications that certify under penalty of perjury the tobacco manufacturer is either a participating manufacturer under the Master Settlement Agreement (MSA), or is a non-participating manufacturer that has made all required escrow payments.
2. All brand families that are listed in the certifications, except as specified.

PENALTIES

This bill would authorize the Board, upon a finding that a distributor has violated this bill's prohibitions or reporting requirements, to revoke or suspend the license or licenses of the distributor in the case of a first offense. In the case of a second or subsequent offense, the Board, in addition to revoking or suspending the distributor's license or licenses, would be authorized to impose a civil penalty not to exceed the greater of either of the following:

- Five times the retail value of the cigarettes or tobacco products, as defined.
- Five thousand dollars (\$5,000).

A distributor would be allowed a defense for a violation provided that:

1. At the time of the violation, the cigarettes or tobacco products claimed to be the subject of the alleged violation belonged to a brand family that was included on the list, as provided.
2. At the time of the violation, the distributor possessed a copy of the Attorney General's most recent written acknowledgment of receipt of the certifications and other information required as a condition of including the brand family on the list, as provided.

However, a defense would not be available to the distributor if, at the time of the violation, the Attorney General had provided the distributor with written notice that the brand family had been excluded or removed from the list, or the distributor had failed to

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provide the Attorney General with a current address for the receipt of written notice through electronic mail.

Any cigarette or tobacco products that are stamped or to which a meter impression is affixed, or for which tax is paid, in violation of this bill's provisions, would be subject to seizure and forfeiture pursuant to the Cigarette and Tobacco Products Tax Law, regardless of whether the violation is subject to a defense, as provided. The cigarettes or tobacco products seized and forfeited would be destroyed.

DISTRIBUTOR CREDIT FOR CIGARETTE AND TOBACCO TAXES PAID

If a distributor affixes a stamp or meter impression to a package of cigarettes, or pays the tax on a tobacco product defined as a cigarette, during the period between the date on which the brand family of the cigarettes or tobacco product was excluded or removed from the list and the date on which the distributor received notice of the exclusion or removal, then both of the following would apply:

- The distributor would be entitled to a credit for the tax paid by the distributor with respect to the cigarette or tobacco product to which the stamp or meter impression was affixed or the tax paid during that period. The distributor would be required to comply with regulations prescribed by the Board regarding refunds and credits, as specified. If the distributor has sold the cigarette or tobacco product to a wholesaler or retailer, and has received payment from the wholesaler or retailer, the distributor would be required to provide the credit to the wholesaler or retailer.
- The brand family would not be included on or restored to the list until the tobacco product manufacturer has reimbursed the distributor for the cost to the distributor of the cigarettes or tobacco product to which the stamp or meter impression was affixed or the tax paid during that period.

REPORTING OF INFORMATION

This bill would require, not later than 25 days after the end of each calendar quarter or more frequently if so directed, each distributor to submit any information as the Board or Attorney General requires to facilitate compliance of this bill's provisions. The distributor would also be required to maintain, and make available to the Board and the Attorney General, all invoices and documentation of sales of all non-participating manufacturer cigarettes and any other information relied upon in reporting to the Board and the Attorney General for a period of five years.

The Board would be authorized to disclose to the Attorney General any information requested by the Attorney General for purposes of determining compliance with and enforcing the provisions of this bill. The Board and Attorney General would be authorized to share with each other, and may share with other federal, state or local agencies, information for purposes of enforcing this bill's provisions and the Model Statute.

MISCELLANEOUS

This bill would not permit persons to be issued a license or granted a renewal of a license to act as a stamping agent unless that person has certified in writing, under penalty of perjury, that the person will comply fully with this bill's provisions.

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This bill would authorize the Attorney General to adopt rules and regulations to, among other things, establish procedures for the seizure and destruction of cigarettes forfeited to the state, including, but not limited to, the state facilities that may be used for the destruction of contraband cigarettes.

This bill is an urgency measure and would become effective immediately upon enactment.

Background

Under the November 1998 MSA between the State of California, other states, and tobacco product manufacturers, each tobacco company must make annual payments to the participating states in perpetuity, totaling an estimated \$206 billion through 2025. California's share of the revenue is projected to be \$25 billion over the next 25 years, based on receiving approximately 12.8% of the total payments. The payments will be split 50/50 between state and local governments under a Memorandum of Understanding negotiated by the Attorney General and various local jurisdictions (cities and counties) which had also sued the tobacco companies.

The payment provisions of the MSA apply to "participating manufacturers" which include both original signatories to the MSA, as well as other companies which subsequently agree to be bound by the MSA. In return for these payments, the states have agreed to release the cigarette manufacturers from all claims for damages, penalties, and fines. In addition, the participating manufacturers have agreed to certain non-economic terms that restrict their advertising and marketing practices and control their corporate behavior. The primary purpose of these restrictions is to prevent marketing of cigarettes to minors and thereby reduce smoking by minors.

In order to safeguard themselves against unfair competition from tobacco products manufacturers who do not participate in the MSA, the MSA contains provisions which would reduce the payments made to states that do not enact a "Model Statute" to require nonparticipating manufacturers to put funds into escrow accounts. The money in the escrow accounts is intended to be available to pay judgements or settlements on any claims brought by the state against any nonparticipating tobacco manufacturers.

In 1999, California enacted a "Model Statute" pursuant to Senate Bill 822 (Escutia, Chapter 780). That bill, among other things, authorized the Board to adopt any regulations necessary to ascertain, based on the amount of state excise tax paid on cigarettes, the number of tax paid cigarettes sold by tobacco products manufacturers who do not participate in the MSA.

While the Settling States, such as California, have been aggressively enforcing the provisions of the Model Statutes, enforcement has proved costly and cumbersome. Accordingly, approximately fifteen States have enacted Complementary Legislation to make state enforcement of Model Statutes more effective and thereby promote the purposes for which the Model Statutes were enacted. Complementary Legislation has been effective in promoting compliance with the Model Statutes, which led to the development of draft Complementary Legislation that could be recommended as a model to all of the Settling States.

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The National Association of Attorneys General (NAAG) Tobacco Committee has recommended that the Attorneys General of the Settling States give serious consideration to the legislation and designate its enactment a priority. The Committee believes that enactment of such legislation by all Settling States will promote the purposes the Model Statutes were designed to serve and safeguard payments to the Settling States that might otherwise be imperiled.

In General

Provisions similar to this bill were contained in last year's AB 2906 (Horton), AB 1666 (Horton), and SB 1843 (Committee on Budget and Fiscal Review). Assembly Bill 2906 died on the Senate inactive file, Assembly Bill 1666 was placed on the Assembly inactive file while waiting for concurrence in the Senate amendments, and SB 1843 passed the Assembly with no further action.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Office of the Attorney General and is intended to protect California's settlement payments under the MSA, which are directly threatened by manufacturers that do not either join the MSA or make the escrow payments required by the Model Statute. The provisions of this bill are very similar to the Model Complementary Legislation developed under the purview of the NAAG's Tobacco Project Committee.

According to the author, California's MSA settlement payments have been significantly less than projected because of declining sales by the four original participating manufacturers. The decline (possibly in the millions of dollars) is partially attributable to increased sales by some non-participating manufacturers who have created an artificial price advantage over participating manufacturers by not making the escrow payments as required by law.

2. **Summary of April 10 amendments.** The amendments to this version of the bill that would affect the Board authorizes the Attorney General to adopt rules and regulations to, among other things, establish procedures for the seizure and destruction of cigarettes forfeited to the state, including, but not limited to, the state facilities that may be used for the destruction of contraband cigarettes.

Other amendments are technical.

3. **The Board would not know the date a distributor affixes a stamp.** This bill would entitle a distributor to recoup excise taxes paid for a cigarette tax stamp that was unlawfully affixed during a specified period. In order to determine whether a distributor is entitled to recoup the excise taxes paid, the Board would need to know the exact date a stamp is affixed. However, the Board has no way of knowing that date.

Beginning January 1, 2005, however, this concern will be addressed by SB 1701 (Ch. 881, Stats. 2002) which requires that the stamps and meter impressions be encrypted with the date the stamp or meter impression was affixed.

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4. **Suggested technical amendments.** The following technical amendments are suggested for consistency with the Cigarette and Tobacco Products Tax Law:

30165.1. (g) (1) Not later than 25 days after the end of each calendar quarter, and more frequently if so directed by the board or the Attorney General, each distributor shall submit any information as the board or Attorney General requires to facilitate compliance with this section, including, but not limited to, a list by brand family of the total number of cigarettes or in the case of roll your own, the ~~equivalent stick count~~ total ounces for which the distributor affixed stamps during the previous calendar month or otherwise paid the tax due for those cigarettes. The distributor shall maintain, and shall make available to the board and the Attorney General, all invoices and documentation of sales of all nonparticipating manufacturer cigarettes and any other information relied upon in reporting to the board and the Attorney General for a period of five years.

(m) No person shall be issued a distributor's license pursuant to Section 30140 ~~license or granted a renewal of a license to act as a stamping agent~~ unless that person has certified in writing, under penalty of perjury, that the person will comply fully with this section.

In addition, Section 30165.1(f)(2) should be amended to delete references to the Board since a nonparticipating manufacturer's "notice of termination of the authority of an agent" does not impact the Board's administration of the Cigarette and Tobacco Products Tax Law.

30165.1. (f)(2) The nonparticipating manufacturer shall provide notice to ~~the board and~~ the Attorney General 30 calendar days prior to termination of the authority of an agent and shall further provide proof to the satisfaction of the Attorney General of the appointment of a new agent no less than five calendar days prior to the termination of an existing agent appointment. In the event an agent terminates an agency appointment, the nonparticipating manufacturer shall notify the ~~board and~~ Attorney General of said termination within five calendar days and shall include proof to the satisfaction of the Attorney General of the appointment of a new agent.

5. **Could a distributor having a defense for a violation be credited the tobacco products excise tax?** Section 30165.1(j)(1) would entitle a distributor having a defense for a violation to recoup taxes paid with respect to the cigarette or tobacco product to which the stamp was affixed, or the tax paid during that period. The distributor would be required to comply with regulations prescribed by the Board regarding refunds and credits that are adopted pursuant to Section 30177.

Section 30177 was written to specifically provide for a refund of the excise tax on cigarettes, which is paid through the application of a cigarette tax stamp to each package of cigarettes prior to distribution. In general, Section 30177 allows for a refund or credit of the tax if cigarettes, contained in a package to which a stamp is affixed, have been destroyed prior to distribution. A refund or credit of the tax is also

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permitted after distribution if the cigarettes have become unsalable *and* have been replaced, *and* the Board has proof of destruction.

Because the term "cigarettes" as defined pursuant to Section 30003 of the Cigarette and Tobacco Products Tax Law does not include tobacco products, the Board would not have the authority under existing law to provide a credit to a distributor for tobacco products defined as a cigarette pursuant to Health and Safety Code Section 104556(d). Board staff is working with the Attorney General's office in drafting appropriate amendments to address this concern.

6. **The Board's inspection authority should be clarified.** The current statutory scheme impliedly grants the Board authority to conduct inspections at locations where cigarettes and tobacco products are sold for the purpose of fulfilling tax collection obligations. However, current law does not directly authorize such inspections. The ambiguity in current law could affect the Board's ability to verify that tax stamps have been affixed to a package of cigarettes, or the tax paid on a tobacco product defined as a cigarette, in accordance with this measure. Therefore, the author may want to consider amending the bill to clarify the Board's inspection authority. The following language is suggested:

30435. (1) Any board employee, upon presenting appropriate credentials, is authorized to enter any place as described in paragraph (3) and to conduct inspections in accordance with the following paragraphs.

(2) Inspections shall be performed in a reasonable manner and at times that are reasonable under the circumstances, taking into consideration the normal business hours of the place to be entered.

(3) Inspections may be at any place at which cigarettes or tobacco products are sold, produced, or stored or at any site where evidence of activities involving evasion of cigarette or tobacco products tax may be discovered.

(4) Any person that refuses to allow an inspection shall be subject to the penalties imposed pursuant to Section 30471.

7. **Does the Attorney General have the statutory authority to promulgate regulations under the Cigarette and Tobacco Products Tax Law?** This bill would authorize the Attorney General to adopt rules and regulations establishing procedures for seizure and the destruction of cigarettes forfeited to the state pursuant to Section 30436 or Section 30449, including, but not limited to, the state facilities that may be used for the destruction of contraband cigarettes. However, it is not clear whether the Attorney General would have the statutory authority to adopt regulations pursuant to the Cigarette and Tobacco Products Tax Law. An exception would be those regulations adopted pursuant to proposed Section 30165.1 since that section would specifically grant the Attorney General such authority.
8. **Related legislation.** Identical provisions are contained in AB 71 by the same author.

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COST ESTIMATE

The Board would incur additional costs to 1) revoke or suspend the license or licenses of the distributor for stamping or paying taxes on brands that are in violation of this bill's requirements, 2) impose additional penalties for violations, 3) provide credit for taxes paid, as specified, 4) prepare reports and answer the requests from the Office of the Attorney General, 5) seize cigarettes, and 6) warehouse and destroy product seized. A detailed cost estimate is pending.

REVENUE ESTIMATE

It is not possible to estimate actual revenue that could be realized by enactment of this bill. It is intended to protect California's settlement payments under the MSA, which are directly threatened by manufacturers that do not either join the MSA or make the escrow payments required by the Model Statute.

However, the following chart shows the difference between the revenues estimated in 1998 from the MSA and the actual payments made.

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